ORIGINAL

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company **Application for review of alternative regulation plan.**	**98-0252**
Illinois Bell Telephone Company **Petition to rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates.**	**98-0335** **(cons.)**
Citizens Utility Board and The People of the State of Illinois **-vs-** **Illinois Bell Telephone Company** **Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.**	**00-0764**

AT&T COMMUNICATIONS OF ILLINOIS, INC.'S REPLY BRIEF ON EXCEPTIONS

AT&T Communications of Illinois, Inc. ("AT&T") hereby submits its Reply Brief on Exceptions in the above docket. While AT&T will reply to certain of the exceptions raised by Staff, McLeod, Ameritech Illinois and the City of Chicago/Government and Consumer Intervenors, or City/GCI, to the Hearing Examiners' Proposed Order ("HEPO), AT&T's silence on an issue is not intended and should not be construed as either agreement or disagreement with a particular position. As AT&T also stated in its Initial Brief, AT&T offers no opinion or argument as to whether the Commission should permit Ameritech Illinois to operate under an alternative form of regulation or whether it should demand that Ameritech return to rate-of-return regulation. Since AT&T's recommendations are premised upon a Commission order permitting Ameritech to

continue to operate under an alternative form of regulation, to the extent the Commission orders that Ameritech Illinois return to rate-of-return regulation, AT&T's recommendations would not apply.

A. The HEPO Correctly Concludes That Carrier Access Services, UNEs And Wholesale Services Should Be Included In The Alternative Regulation Plan Within The Current Four Basket Structure.

In its Brief on Exceptions, Ameritech argues that the four basket structure adopted by the HEPO for the placement of Ameritech's noncompetitive services should be collapsed into a single basket.[1] Contrary to its Brief on Exceptions, however, Ameritech's Initial Brief in this matter actually *supports* maintaining the current four basket structure should Ameritech continue to operate under an alternative form of regulation.[2] Ameritech's Initial Brief correctly noted that according to Section 13-506.1 of the Illinois Public Utilities Act, no alternative regulation plan adopted by the Commission should unduly or unreasonably prejudice or disadvantage any particular customer class (Section 13-506.1(b)(7)), nor should it result in discrimination or cross-subsidies. Section 13-103(d). As Ameritech conceded in its Initial Brief, "[t]he [four] basket structure and residential rate protections *functioned precisely as the Commission*

[1] Ameritech argues that all residential services, including vertical features and installation services, should be included in the (only) Residence Basket because the Illinois General Assembly now considers vertical features as standard components of customer service. Ameritech's argument is undermined by the fact that one of the three new required service packages Ameritech will be required to offer pursuant to House Bill 2900 includes no vertical services whatsoever.

[2] Ameritech's argument for pricing flexibility, which AT&T addresses below, assumes retention of the current four basket structure. Ameritech, on page 17 of its Brief on Exceptions states, "The overall financial effect, of course, would have to be revenue neutral within the context of the PCI for each basket, which means that other service rates would be reduced by an equivalent amount."

intended. All rate reductions required by the Plan were flowed through equitably to each customer group." Ameritech Initial Br. at 30 (emphasis added). As Ameritech also accurately pointed out, "[t]hese [four] baskets were structured to ensure that all customers benefited from price regulation" (see Ameritech Initial Br. at 44, citing the 1994 Order at pp. 68-69), and the Commission's 1994 Alt Reg Order concluded that "the [four] basket structure would ensure that all customer classes would be treated equally." Ameritech Initial Br. at 30, citing the 1994 Order at pp. 190-191.

The Commission originally approved the four-basket structure to ensure that all customer classes were treated equitably, free from discrimination and cross-subsidies. Thus, there is no dispute that the four-basket structure has worked precisely as the Commission envisioned and intended, and the HEPO correctly determines that the same four basket structure should continue under Ameritech's new alternative regulation plan. The four-basket structure is a tried and true mechanism to ensure that all customer classes are protected and treated equitably. There is no less of a need now to ensure that these protections and equities continue.

Nonetheless, inconsistent with the statements made in its Initial Brief, Ameritech, in its Brief on Exceptions, contends that the four-basket structure adopted by the HEPO should be rejected, and that the four baskets should be consolidated into a single basket because "there is virtually nothing left in either the Business or Carrier baskets to which the price index can or should apply." Ameritech Brief on Exceptions, p. 19. Ameritech

is wrong for several reasons, and the HEPO's conclusion that the current four basket structure should be maintained is correct.[3]

1. AT&T Recommends That The Business Basket Be Retained To Include All Business Wholesale Services.

Ameritech is correct that House Bill 2900 – the new legislation (assuming it is signed by the Governor) -- will allow Ameritech to reclassify its business services as competitive. This does not lead to the natural result – as Ameritech would have the Commission believe – that the Business Basket necessarily goes away. To the contrary, as AT&T explained and recommended in its Brief on Exceptions (pp. 4-6), all wholesale services should appropriately be placed in the same basket as the corresponding retail service or, if the retail service has been reclassified as competitive, in the same basket the retail service would have been placed had it been included in the alternative regulation plan. As AT&T's Brief on Exceptions demonstrates, placement of wholesale services in this way will ensure that all customer classes fairly and equitably benefit from any rate reductions Ameritech is required to make by operation of the price cap mechanism. Assuming the HEPO adopts AT&T's proposal, the Business Basket would not be empty; rather, it would include all of Ameritech's wholesale business services, thereby assuring a hearty Business Basket to include in Ameritech's alternative regulation plan.[4]

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[3] AT&T agrees with the Exceptions filed by GCI/City that the four basket structure should be continued and that Ameritech's request for basket consolidation should be rejected. GCI/City Brief on Exceptions, p. 44.

[4] Because AT&T recommends that all wholesale business services be included in the Business Basket, AT&T disagrees with Staff Exception No. 20 recommending that the Business Basket be eliminated and a three basket structure adopted. If, however, the Commission rejects AT&T's proposal regarding the placement of wholesale services, AT&T would concur with Staff's proposed three basket structure. Staff Brief on Exceptions, pp. 35-36.

2. The HEPO Appropriately Includes Carrier Access Services, UNEs, Interconnection And Transport And Termination Services In The Carrier Basket.

Ameritech also misleadingly contends in its Brief on Exceptions that there is "virtually nothing left" in the Carrier Basket, thus warranting the institution of a single basket structure. Ameritech's contention not only grossly misstates the HEPO's conclusions, but it is incorrect as a matter of fact and as a matter of law. Contrary to Ameritech's contention, the HEPO's conclusions result in a plentiful Carrier Basket, including carrier access services, UNEs, interconnection, transport and termination services and, if the Commission rejects AT&T's recommendation to include wholesale services in the same basket as the corresponding retail service, wholesale services as well. Ameritech's contention that the Carrier Basket should be eliminated is premised on nothing more than a rehash of the arguments Ameritech has already made regarding several of the carrier services being subject to independent pricing constraints contained in various Commission orders -- arguments that the HEPO has already soundly rejected.

a. The Existence Of Additional Pricing Constraints Has No Bearing On The Ability Of Noncompetitive Services To Benefit From The Price Cap Mechanism.

As AT&T indicated in its Initial Brief, the fact that the pricing of various noncompetitive services may be subject to additional pricing constraints does not lead to the conclusion that these services should not be included in the price cap mechanism or that subjecting them to the price cap mechanism would not be beneficial. AT&T Initial Br. at 6-8; CUB Initial Br. at 67; City of Chicago Initial Br. at 41; State Attorney General Initial Br. at 63; Cook County State's Attorney Initial Br. at 38. The fact that certain noncompetitive services may be subject to additional, independent pricing constraints does not -- in any way -- mean that these services cannot also be included in the price cap

plan, nor does it mean that subjecting these services to the price cap mechanism would not be beneficial. To the contrary, the price cap provisions could provide a convenient, low cost, and routine approach to updating the rates derived initially through cost studies, thus avoiding or deferring lengthy and contentious proceedings to evaluate cost studies and update rates for these services, and furthering the goal of reducing regulatory resources. GCI Ex. 1.0, pp. 50-52 ; AT&T Ex. 1.0, p. 6.

For example, the fact that carrier access services are subject to the pricing constraints contained in the Commission's Phase II Order in ICC Docket Nos. 97-0601/0602 does not provide a legitimate basis for excluding carrier access services from the Carrier Basket. To the contrary, at the time the initial alternative regulation plan was adopted, Ameritech Illinois' intrastate access charges were capped at the rate level of their interstate counterparts, yet the Commission did not exclude carrier access services from the price cap mechanism, and should not do so now. GCI Ex. 11.0, p. 53. In fact, carrier access services have been in the Carrier Basket since the Plan's inception, and should remain there.

Nor do the actual independent pricing constraints themselves prevent the Commission from subjecting carrier access services to the price cap mechanism. To the contrary, as AT&T's Initial Brief discussed at length, including carrier access services in the price cap mechanism will ensure that switched access rates properly reflect cost reductions as Ameritech's cost of providing access services declines over time, and may also reduce the need to update switched access cost studies periodically, thereby avoiding or deferring lengthy and contentious regulatory review of Ameritech's cost studies. AT&T Initial Br. at pp. 5-8. Ameritech agrees that changes in both LRSIC costs and the

common overhead allocation to carrier access charges could decline over time. Ameritech Initial Br. at 47. The same reasons and rationales for including carrier access services in the Carrier Basket also support including UNEs, interconnection and transport and termination services in the Carrier Basket. AT&T Initial Br. at pp. 8-14.

In contending that "there is virtually nothing left in the Carrier Basket" as a consequence of its (rejected) proposal that various carrier services be excluded from the alternative regulation plan, Ameritech essentially ignores the Illinois Public Utilities Act. In fact, Section 13-506.1 of the Illinois Public Utilities Act contains no provisions that would authorize the complete exclusion of a subset of noncompetitive services (i.e., carrier to carrier services) from alternative regulation. At the same time, it does not appear necessary to treat all noncompetitive services exactly the same under an alternative regulation mechanism.

In addition to the fact that Section 13-506.1 prohibits Ameritech's proposal to remove its litany of services from the price cap plan, two additional overriding concerns prevent the removal of certain noncompetitive services from the price cap mechanism entirely, even if they are subject to other pricing constraints. First, excluding services from the price cap mechanism would lead to smaller revenue reductions than would otherwise occur if the PCI decreases. The price cap formula is intended to estimate indirectly the amount by which Ameritech Illinois' costs for *all* services, including all noncompetitive services, change over time. In the 1993/94 alternative regulation proceeding, Ameritech Illinois had proposed to exclude basic residential services, which were subject to a statutory rate cap, from the residential basket. With the expectation that the PCI could decrease, Staff opposed Ameritech Illinois' proposal, pointing out that

excluding basic residential rates from the residential basket would preclude rate decreases that properly should be made. GCI Ex. 1.0, pp. 48-49. The Commission agreed with Staff, and ordered that basic residential rates be included in the alternative regulation plan.[5]

This same situation could occur if the HEPO adopts Ameritech Illinois' exception requesting that carrier access services, UNEs and wholesale services be removed from the alternative regulation plan. While cost studies may not be performed annually to update rates for access services, for example, Ameritech Illinois' costs would change, presumably downward given the declining cost industry, over time. Including these services in the price cap mechanism would allow any cost changes to be reflected in rates more quickly than would be practical if, in the alternative, cost studies were required by the Commission to support these same cost changes. GCI Ex. 1.0, p. 49. Moreover, any need to review or investigate cost studies, if required, would only inject further delay into the process of implementing Ameritech's cost changes.

Thus, Ameritech is simply wrong that consolidation of the four baskets is appropriate because there is virtually nothing left in the Carrier basket. Ameritech's true motivation lies in the fact that excluding services from the price cap mechanism would mean smaller revenue reductions than would otherwise occur if the PCI decreases, as aptly described by CUB. CUB Initial Br. at 65. Carrier access charges are included in the carrier basket and should remain there, and UNEs, interconnection and transport and

[5] Alt. Reg. Order at 68-69.

termination services should be included as well. Appropriately structured, the Carrier Basket should be plentiful. AT&T Reply Brief, p. 9.

b. The HEPO Correctly Concludes That UNEs Should Be Placed In The Carrier Basket.

Nothing in Ameritech's Brief on Exceptions supports excluding UNEs, interconnection and transport and termination services from the price cap mechanism. Ameritech has conceded that the Commission's core regulatory responsibility in adopting a price regulation plan is to "assure the availability, affordability and quality of services for which customers do not yet have a competitive alternative." Ameritech Initial Br. at 2. There is no dispute that customers do not have competitive alternatives for UNEs; hence, UNEs are appropriately classified by Ameritech as noncompetitive. As such, there is no legitimate reason to single these services out for exclusion from the price cap plan, or to assume that the above-stated core regulatory responsibility of the Commission does not also apply to UNEs, interconnection and transport and termination services.

Ameritech also contends that the TELRIC Order does not establish a price ceiling and that a reduction in the price index does not correspond to a reduction in TELRIC costs for UNEs, interconnection and transport and termination services. Ameritech Brief on Exceptions, pp. 22-23.

Specifically, Ameritech's rationale for excluding UNEs from the price cap mechanism is that the Commission excluded UNEs from the Plan in its Order in ICC Docket No. 96-0486/0569 because the federal Act requires that UNEs be set at TELRIC plus an appropriate allocation of shared and common costs. Ameritech Brief on Exceptions, p. 21. The HEPO correctly rejects these far-reaching arguments. As AT&T discussed in its Initial Brief, moreover, the Commission's Order in ICC Docket Nos. 96-

0486/0569 expressly declined to include UNEs, interconnection and termination and transport services in the Plan ***"at the present time,"*** clearly evidencing an intent to revisit and reconsider its decision as the regulatory landscape unfolded in the wake of the then recently enacted federal Act. AT&T Initial Br. at 10-14. As the HEPO correctly concludes, time and experience have demonstrated that the reasons enumerated by the Commission for excluding UNEs from the price cap mechanism ***at that time*** are no longer valid reasons for depriving the customers purchasing these services from the benefits of the price cap mechanism. *Id.*

The rates for UNEs, Interconnection and Transport and Termination services are based on the total element long run incremental cost, or TELRIC, of providing the element, plus an allocation of shared and common costs. The TELRIC Order requires that Ameritech set its UNE rates no higher than the TELRIC of the element and the Commission approved allocation of shared and common costs. In fact, the shared and common cost markup for UNEs, Interconnection and Transport and Termination is even more generous than the 28.86% maximum shared and common cost allocation Ameritech is permitted to use when pricing carrier access services.[6] Given the extremely generous shared and common cost markup Ameritech is allowed to assess to UNEs pursuant to the

[6] Ameritech contends that the shared and common cost markup is not a part of the record in this case. AT&T did not introduce the exact percentage into the record because until its direct testimony was filed in ICC Docket No. 00-0700, it was AT&T's understanding that the percentage was proprietary. Ameritech witness Mr. Palmer has now publicly testified that the current percentage markup is 34.55% (see Ameritech Illinois Ex. 2.0, ICC Docket No. 00-0700, p. 9). Moreover, the TELRIC Order at page 37 notes that "On average, Ameritech Illinois' allocation of shared and common costs to UNEs is 29 percent of the 'extended TELRIC'".

Commission's Order in ICC Docket Nos. 96-0486/0569, there is no legitimate concern that Ameritech's UNE rates are in fear of falling below the TELRIC of the respective elements as a result of the operation of the price cap mechanism.

Nothing in the Commission's TELRIC Orders resulting from Ameritech Illinois' TELRIC investigations (ICC Docket No. 96-0486/0569) prohibits reducing the rates for these services below the rates filed in compliance with these Commission orders, nor would reduced rates resulting from the operation of the price cap mechanism violate the TELRIC requirements provided they do not fall below the pre-marked up levels. AT&T Ex. 1.0, p. 7.

Nor would including UNEs in the price cap mechanism in any way limit Ameritech Illinois' ability to negotiate rates. GCI Ex. 1.0, p. 55. Ameritech Illinois is not required to change the rates of each and every service in a given basket to comply with the requirements of a price cap formula. Instead, the Company can selectively apply mandated rate changes within a basket, subject to the annual pricing flexibility limits and any individual rate constraints that may exist. As a result, Ameritech can maintain negotiated rates even under price caps. Id.

Finally, inclusion of these services in the price cap mechanism would not violate the pricing requirements of the 1996 Act. As with carrier access services, there is no inconsistency between forward-looking cost-based pricing and including services subject to that pricing standard in the price cap mechanism. The forward-looking cost-based rates adopted in the TELRIC Order for non-negotiated UNE, interconnection, and transport and termination services are rate *caps* or *ceilings;* they are not price floors or freezes below which these rates cannot fall. Further, the price cap formula is designed to

capture efficiency gains achieved by Ameritech Illinois in providing service over time. There is no reason to assume that these efficiency gains will not also flow to the provision of UNEs, interconnection, and transport and termination services. It would be grossly inequitable to deprive CLECs and their customers of these efficiencies. Id.

Rather than allowing the price cap formula to ensure that UNE rates receive the efficiency gains achieved by Ameritech, Ameritech's suggests, in the alternative, that the "Commission can institute an investigation into Ameritech Illinois' UNE rates at any time to determine whether the underlying, forward-looking incremental costs or the forward-looking shared and common costs have declined since 1998." Ameritech Brief on Exceptions, p. 25. Anyone involved in the original investigation of Ameritech's TELRIC studies experienced firsthand the enormous amount of resources expended by the Commission and all interested parties in the almost year and a half it took to adequately analyze and investigate those studies. Not only would repeated Commission investigations of Ameritech's TELRIC studies inject lengthy and contentious delay and a significant drain on precious Commission and carrier resources, but it would deny UNE purchasers the benefits of Ameritech' efficiency gains pending completion of the investigation.

For all the reasons set forth above, the HEPO properly concludes all UNEs, interconnection and transport and termination services should be included in the Carrier Basket under the alternative regulation plan.

c. The HEPO Correctly Concludes That Carrier Access Services Should Be Included In The Carrier Basket.

Ameritech Illinois contends that there is no basis for including access services in the alternative regulation plan since rates for switched access services are now

"independently" set based on a Commission-prescribed formula. Specifically, Ameritech contends that because the Commission's Phase II Order in ICC Docket Nos. 97-0601/0602 ("Phase II Order") requires it to price carrier access services at their long run service incremental cost, or LRSIC, plus an allocation of shared and common costs *not to exceed but to be capped at* 28.86%, there is no basis for or need to include carrier access services in the price cap plan.

While Ameritech now concedes that the 28.86% shared and common overhead allocation established by the Commission in the Phase II Order is a "maximum" allocation of shared and common costs (Ameritech Brief on Exceptions, p. 26), Ameritech contends that the Commission cannot require Ameritech to reduce its carrier access rates without substantial evidence that Ameritech's shared and common costs have changed or that the price index accurately measures such changes, and that downward adjustments based on the price index would result in carrier access rates which are below the level determined by the Commission to be just and reasonable. Ameritech Brief on Exceptions, pp. 26-27.

First, Ameritech provides no support for its position limiting the Commission's authority – undoubtedly because none exists. The LRSIC plus 28.86% rate cap established by the Commission for Ameritech's carrier access rates in no way precludes reductions to switched access rates below the maximum allowable markup of 28.86%, and should not be used as an excuse to deprive interexchange carriers and their customers of the benefits associated with rate decreases due to price cap regulation. GCI Ex. 1.0, p. 51. Moreover, the fact that carrier access rates subject to this rate cap have been included in the price cap mechanism for more than a year seriously undermines Ameritech's

argument that the Commission cannot include carrier access rates in the price cap mechanism.

Ameritech's rationale for excluding carrier access services from the price cap mechanism blatantly misstates the Commission's Phase II Order in ICC Docket Nos. 97-0601/0602. In fact, nothing in the Commission's Phase II Order provides for or justifies removal of carrier access services from the price cap mechanism.

Ameritech contends that the Commission's Phase II Order sets switched access rates *at* LRSIC plus a 28.86% common overhead allocation, and that reducing carrier access rates below that maximum level as a result of operation of the price cap index would result in rates that are unjust and unreasonable. Ameritech Brief on Exceptions, p. 26. One need only refer to the plain language of the Phase II Order itself to determine that Ameritech's interpretation of the Commission's Phase II Order is flawed. Indeed, nothing in that Order even remotely suggests that reducing carrier access rates as a result of the price cap mechanism would result in rates that are unjust and unreasonable:

> Accordingly, we adopt the shared and common cost percentages for switched access rate elements contained in AT&T Gebhardt Cross Ex. 1A, page 3, and conclude *that the maximum shared and common cost contribution shall be 28.86%* for both Ameritech's and GTE's cost-based switched access rate elements.

Order dated March 29, 2000, ICC Docket Nos. 97-0601/0602, p. 51 (emphasis supplied). Because the Commission's Phase II Order has already determined that any shared and common cost allocation up to a maximum allocation of 28.86% is just and reasonable, Ameritech's exception requesting that carrier access rates be removed from the price cap plan must be rejected.

Ameritech's further suggestion that any reductions to its LRSIC costs and common overhead allocations for carrier access services can only be mandated by the Commission as a result of substantial evidence that such costs have changed is of little comfort. As the almost three years it took to litigate ICC Docket Nos. 97-0601/0602 unequivocally demonstrates, the process of investigating and litigating Ameritech's cost studies is almost inevitably a lengthy, contentious and resource intensive process for both the Commission and the interested parties. GCI Ex. 1.0, pp. 51-52. The price cap provisions could provide a convenient, low cost and routine approach to updating the rates derived initially through cost studies, thus avoiding or deferring these lengthy and contentious proceedings to evaluate cost studies and update rates for these services, and furthering the goal of reducing regulatory costs.

Ameritech also implies that including carrier access services in the Carrier Basket is somehow inappropriate since the cost changes reflected in the X factor do not accurately measure changes in its access LRSICs or shared and common costs. Ameritech made this same argument in its briefs – an argument the HEPO soundly rejected. To the contrary, continuing to include carrier access services in the price cap mechanism is entirely consistent with forward-looking cost-based pricing of switched access services. As Ameritech Illinois' cost of providing access services declines over time, switched access rates should properly reflect the reduced cost. Ameritech Illinois' cost reductions are reasonably captured by the PCI, which reflects Ameritech Illinois' input prices and productivity. GCI Ex. 1.0, p. 51.

Moreover, including carrier access services in the price cap mechanism may also reduce the need to update switched access cost studies periodically, thereby avoiding or

deferring lengthy and contentious reviews of Ameritech Illinois' cost studies -- an outcome consistent with the goal of reducing regulatory costs and delays. GCI Ex. 1.0, pp. 51-52. In fact, not only will any reduction of access LRSICs be captured by the price cap mechanism, but to the extent Ameritech Illinois' forward looking shared and/or common costs decrease, continuing to include access services in the price cap mechanism would allow this cost reduction to be reflected in access rates as well. The HEPO's conclusion that carrier access services continue to be included in the Carrier Basket is consistent with this price cap mechanism benefit, and the Commission should adopt it.

Finally, the fact that Ameritech's carrier access rates are subject to the independent pricing constraints in no way precludes the Commission from continuing to include carrier access services in the price cap plan now. Notably, the Commission has not in the past excluded carrier access charges from the parameters and policies of the alternative regulation plan simply because they were subject to independent pricing constraints. For example, at the time the alternative regulation plan was originally adopted, Ameritech Illinois' intrastate access charges were previously capped at the rate level of their interstate counterparts, yet the Commission did not exclude access services from the price cap mechanism because carrier access services were subject to that additional pricing constraint. GCI Ex. 1.0, pp. 50-51. Likewise, the Commission should not exclude access services from the price cap mechanism now.

For these reasons, Ameritech Illinois' switched and non-switched access services should continue to be included in the Carrier Basket and should continue to be subject to the price cap mechanism.

d. Wholesale Services Should Be Included In The Alternative Regulation Plan And Placed In The Same Basket As The Corresponding Retail Service.

Ameritech Illinois claims that there is no basis for including its wholesale services in the alternative regulation plan since these services are priced in accordance with the wholesale formula adopted by the Commission in Dockets 95-0458/0531 (consol.), which complies with the federal Act's avoidable cost methodology. Ameritech Brief on Exceptions, pp. 25-26. For all the same reasons noted above, Ameritech's wholesale services should be included within the price cap mechanism.

While Ameritech is correct that the Commission's Order in ICC Docket Nos. 95-0458/0531 ("Wholesale Order") sets wholesale rates based upon the avoided cost standard set forth in the federal Act, Ameritech contends that "nothing in TA96 contemplates further reductions." Ameritech Brief on Exceptions, p. 26. More accurately stated, however, nothing in the federal Act *precludes* further reductions to wholesale rates. In fact, Ameritech itself conceded at page 47 of its Initial Brief that "wholesale rates must decline with their retail counterparts." Thus, to the extent Ameritech experiences cost reductions, wholesale services should also benefit from those reductions by operation of the price cap mechanism.

Moreover, wholesale services have been included in the alternative regulation plan for the almost six years since the Commission adopted its Wholesale Order. As AT&T explained in detail in its Initial Brief and in its Brief on Exceptions, the Commission should include wholesale services within the alternative regulation plan for the same reasons carrier access charges and UNEs should be included, except that they

should be placed in the same basket as the corresponding retail service. AT&T Initial Br. at 14-18; AT&T Brief on Exceptions, pp. 4-6.

As AT&T explained in its Brief on Exceptions, however, it is more appropriate to include these services in the same basket as the corresponding Ameritech retail service. If the companion retail service has been classified as competitive, the wholesale service should be placed in the basket where the retail service would have been if it were classified as noncompetitive. That way, if Ameritech raises retail rates of services prematurely reclassified as competitive and correspondingly increases its wholesale rates for these services, the wholesale rate increases must be offset by reductions in the rates of other noncompetitive services within that same basket. GCI Ex. 1.0, p. 60.

Furthermore, because resale of residential wholesale services is restricted to residential consumers, the same consumer classes will be addressed independent of other customer classes. Contrary to the objective offered by Ameritech Illinois witness Mr. O'Brien (i.e., the purpose of a single basket is to rectify past differences between basic residential services and other services (Am Ill. Ex. 3.1, p. 12)), assigning wholesale services would restrict Ameritech Illinois's ability to unilaterally rebalance its noncompetitive rates. AT&T Ex. 1.0, p. 8. If wholesale services are assigned in this manner, reductions associated with the mandated pricing relationship between Ameritech Illinois' retail services and wholesale services as established in the Commission's Wholesale Order would be addressed within the relative retail consumer and business service baskets. AT&T Ex. 1.0, p. 8. Carrier access services and UNEs, Interconnection, and Transport and Termination services would not be deprived of reductions that Ameritech could, and no doubt would, otherwise direct to wholesale services.

Accordingly, AT&T recommends that Ameritech's exception requesting that wholesale services be removed from the price cap mechanism be rejected, and that the HEPO be revised consistent with the treatment of wholesale services set forth in AT&T's Brief on Exceptions.

B. The HEPO Appropriately Rejects Ameritech's Request For Additional Pricing Flexibility.

Ameritech further contends that consolidating the basket structure and increasing the permitted percentage price changes for individual services will "allow greater flexibility in structuring discounted service packages for customers, and it will permit a meaningful opportunity to restructure rates across customer classes." Ameritech Brief on Exceptions, p. 19 and pp. 14-17.

As Ameritech has already conceded, however, the existing four-basket structure was adopted for the express purpose of restructuring rates across all customer classes fairly and equitably, and has worked well to serve that goal. In fact, adopting Ameritech's proposal would permit Ameritech to engage in the type of discrimination and inequities between and among customer classes that the Commission has succeeded in eliminating to date. As such, the Commission should reject Ameritech's proposal to consolidate the basket structure.

Consolidating all noncompetitive services into a single basket will only serve to upset the fair and equitable balance that exists today. Indeed, by lumping all noncompetitive services into one basket and allowing Ameritech to pick and choose which customer classes in that single basket get reductions and which ones do not is a sure recipe for discrimination. As CUB accurately notes, "[w]ithout the four-basket structure, AI would be in a position to unilaterally determine which customer classes

would benefit from annual rate reductions, and which customers would be excluded from such benefits and even saddled with rate increases." CUB Initial Br. at 62.

Nor is consolidation of the basket structure necessary to give Ameritech the pricing flexibility it seeks. As AT&T discussed in detail in its Initial Brief, carrier access charges and UNE rates are capped, not frozen, at their forward looking cost (i.e., TELRIC or LRSIC plus an allocation of shared and common costs). AT&T Initial Br. at 5-6. See also GCI Ex. 11.0, p. 53. These rate caps do not in any way preclude Ameritech from reducing prices for carrier access services or UNEs to less than the maximum allowable marked-up rates. *Id.* For Ameritech's carrier access services, the shared and common cost allocation cap is 28.86%; for its UNEs, the allocation is even more substantial. These generous markups provide Ameritech with more than enough pricing flexibility for these services.

Ameritech appears to be laboring under the misguided premise that implementation of price flexibility must result in revenue neutral guarantees. Moreover, as both AT&T and Staff noted, Ameritech has failed to explain why it needs *any* significant level of flexibility to price services for which it has no competitors. Because Ameritech obviously does not need to reduce rates in response to competitive pressure since none exists, Ameritech can only be seeking such flexibility because it wants to increase rates for services for which there is no competition. Thus, AT&T agrees with Staff, CUB and other parties that Ameritech's attempt to impose this "Ramsey pricing" scheme upon captive customers should be rejected. Staff Initial Br. at 41-42; CUB Initial Br. at 62; AT&T Reply Brief, p. 11. Accordingly, Ameritech's exception seeking additional pricing flexibility should be rejected.

C. The HEPO Correctly Rejects Ameritech's Request For Immediate Exogenous Factor Treatment For Any And All Commission-Mandated Rate Reductions.

The conflicting exceptions filed by Staff and GCI/City only further demonstrate (as AT&T discussed in its Brief on Exceptions) that the HEPO's conclusions regarding the Z factor must be clarified. According to Staff's Brief on Exceptions (pp. 31-32), Staff interprets the HEPO as requiring Ameritech to file for exogenous factor treatment within 30 days of the triggering event. AT&T disagrees with Staff's Exception No. 16. GCI/City, while agreeing that the HEPO requires clarification, interprets the HEPO as requiring that Ameritech file for exogenous factor treatment on both an annual basis and within 30 days of the triggering event.

As AT&T stated in its Brief on Exceptions, the HEPO should clarify that Ameritech continue to file for exogenous factor treatment on an annual basis only, and that Ameritech not be required to file for such treatment every time a triggering event occurs. Implementation of Ameritech's Exceptions would eliminate one of the current and significant filing thresholds, i.e., Ameritech is restricted from requesting exogenous factor treatment for triggering events that have occurred within the twelve months of implementation of the annual filing. AT&T also agrees, therefore, with City/GCI's Brief on Exceptions that the HEPO should make clear that the Z factor rules remain unchanged, and that the Commission retains the discretion to determine whether Ameritech is entitled to exogenous factor treatment for any and all Commission-mandated rate reductions. City/GCI Brief on Exceptions, pp. 34-36. As AT&T has repeatedly and consistently contended, Ameritech should not be granted exogenous factor treatment in those instances where the Commission-mandated rate reduction occurred as

a result of a Commission determination that Ameritech's rates were ***unjust and unreasonable***, as well as in those instances where Ameritech raises its rates in violation of the pricing flexibility parameters of the alternative regulation plan itself. It would be ironic, indeed, and wrong, at best, to adopt an alternative regulation plan that entitles Ameritech to exogenous factor treatment for Commission-mandated rate reductions which Ameritech must implement as a result of its violation of the pricing parameters of that very same plan.[7] Accordingly, the HEPO's conclusions regarding the Z factor should be clarified consistent with the Exceptions filed by AT&T and City/GCI.

D. The HEPO Should Be Clarified To Reflect the Fact That Effective Competition Has Not Developed Under The Price Cap Plan And Cannot Be Relied Upon To Constrain Prices Or To Substitute For Regulation.

AT&T agrees with the Exceptions filed by GCI/City concerning the competition component of the alternative regulation plan. GCI/City Brief on Exceptions, pp. 27-29. Specifically, AT&T agrees that to the extent the HEPO concludes that there is a causal connection between the alternative regulation plan and competition, effective competition has not developed during the life of the price cap plan and, as such, certainly cannot be relied upon to constrain prices or substitute for regulation.

E. The HEPO Should Be Modified To Reset The API and PCI To 100.

Consistent with its Brief on Exceptions, AT&T agrees with Staff and GCI/City that the HEPO should be modified to reset the API and the PCI to 100. Staff Brief on

[7] For example, in ICC Docket Nos. 97-0601/0602, one of the issues litigated in Phase I of that docket was whether Ameritech's local switching (LS2) rate increase had exceeded – and therefore violated – the pricing parameters of the alternative regulation plan. The Commission concluded that it did, and ordered Ameritech to reduce its unjust and unreasonable LS2 rate. Interim Order dated December 16, 1998, ICC Docket Nos. 97-0601/0602/0516, p. 20.

Exceptions, pp. 3-7; GCI/City Brief on Exceptions, pp. 45-46. As AT&T noted in its Brief on Exceptions, and as Staff agrees, the HEPO incorrectly concludes that reinitialization of the API and the PCI would serve as a disincentive to operate efficiently. AT&T Brief on Exceptions, pp. 6-7. To the contrary, the earnings Ameritech is entitled to retain as a result of its efficiencies is most certainly a strong enough incentive – even with reinitialization – to encourage Ameritech to operate efficiently. AT&T also agrees with Staff that resetting the API and PCI to 100 will restore the ability of the Carrier Basket to pass on company-side efficiency gains to carrier customers, thereby furthering one of the primary goals of the alternative regulation plan. Staff Brief on Exceptions, pp. 3-7. Accordingly, AT&T recommends that the HEPO be modified to reset the API and PCI to 100 consistent with the exceptions filed by AT&T, Staff and GCI/City.

F. The HEPO Should Be Modified To Include Penalties For Premature Service Reclassification.

Consistent with its Brief on Exceptions, AT&T agrees with the Exceptions filed by both Staff and GCI/City that the HEPO should be modified to institute the reclassification penalties recommended by Staff and GCI/City. GCI/City Brief on Exceptions, p. 47; Staff Brief on Exceptions, pp. 7-9. As AT&T noted in its Brief on Exceptions, it is appropriate for the HEPO to adopt reclassification penalties that will require Ameritech to exercise a high degree of scrutiny and caution prior to reclassifying a noncompetitive service as competitive. AT&T Brief on Exceptions, pp. 7-8. As Staff accurately notes in its Brief on Exceptions, the HEPO incorrectly concludes that imposing penalties for premature reclassification has a negative impact on competition. To the contrary, it is allowing Ameritech to prematurely reclassify services -- penalty-

free – when competition does not in fact exist that causes a negative impact on competition. Staff Brief on Exceptions, p. 8.

Accordingly, the HEPO should be modified consistent with the exceptions filed by AT&T, Staff and GCI/City to impose upon Ameritech the penalties for premature reclassification of services recommended by Staff and GCI/City.

G. The HEPO Correctly Rejects Ameritech's LFAM Model.

The fact that Ameritech has supposedly "devoted a substantial amount of time, effort and expense" developing the LFAM Model is completely irrelevant to its usefulness in determining the costs of Ameritech's network access lines. Ameritech Brief on Exceptions, p. 43. The quantity of resources Ameritech has allegedly expended has nothing to do with the quality of the LFAM Model and the results it produces. The HEPO correctly concludes that the LFAM Model is riddled with numerous and severe, indeed fatal, flaws and deficiencies, and correctly rejects the Model outright in this docket.

Moreover, Ameritech has numerous cost studies on file with the Commission as a result of the Commission's Merger Order in ICC Docket No. 98-0555 that will require in-depth analysis and scrutiny. Ameritech's LFAM Model can be further investigated, if necessary, in this global cost study investigation once the Commission initiates it.

H. The HEPO Should Be Modified To Include The Condition 30 Service Quality Measures and Penalties.

Consistent with its Brief on Exceptions, AT&T agrees with Staff's exceptions recommending that the performance measurements and penalties for failure to meet those benchmarks adopted pursuant to Condition 30 of the Commission's Merger Order in ICC

Docket No. 98-0555 be incorporated into Ameritech's alternative regulation plan and continue in effect during the life of the plan.

Specifically, Condition 30 requires Ameritech Illinois to take 122 performance measurements used by its parent company, SBC, and, after making necessary state-specific modifications, to implement them in Illinois. Condition 30 also subjects Ameritech Illinois to a performance penalty plan in the event Ameritech Illinois provides substandard wholesale services to CLECs. According to Staff witness Mr. McClerren, Condition 30 expires within three years of the merger closing date, i.e., October 2002. AT&T Ex. 1.0, p. 10. Ordering that the Condition 30 benchmarks and penalties be incorporated into and continued in effect during the life of the plan is consistent with Section 13-506.1 of the Illinois Public Utilities Act, which requires that any alternative regulation plan must "maintain the quality and availability of telecommunications services." There is no dispute that end user consumers purchasing resold local exchange service are affected by poor Ameritech Illinois service quality in the same way as Ameritech Illinois' retail customers.

AT&T agrees with Staff that McLeod's proposal that issues concerning wholesale service quality be addressed in ICC Docket No. 01-0120 does not accomplish the crucial objective of ensuring that Ameritech's wholesale customers receive quality service given the scope and structure of ICC Docket No. 01-0120. Staff Brief on Exceptions, pp. 20-21. Accordingly, to ensure the quality of wholesale services and to ensure compliance with Section 13-506.1 of the Illinois Public Utilities Act, AT&T agrees with Staff Exception No. 7 and the exceptions filed by GCI/City (pp. 79-80) that all performance measurements and the Remedy Plan in effect pursuant to the Merger conditions

scheduled to expire in October 2002 should continue, without interruption, during the life of the alternative regulation plan. In fact, it is essential that this occur if service quality is to be maintained.

I. The HEPO Should Be Modified To Clarify That Ameritech's Obligations Under Its Alternative Regulation Plan Are In Addition To, Rather Than In Lieu Of, Its Obligations Pursuant To The Illinois Public Utilities Act.

AT&T agrees with Staff Exception No. 23 which seeks to clarify the HEPO to make clear that any and all obligations imposed upon Ameritech under its alternative form of regulation – assuming one is adopted by the Commission – are in addition to rather than in lieu of any and all obligations imposed upon Ameritech under the Illinois Public Utilities Act.

WHEREFORE, AT&T Communications of Illinois, Inc. respectfully requests that the Hearing Examiners' Proposed Order be modified consistent with AT&T's Brief on Exceptions and the foregoing Reply Brief on Exceptions.

Respectfully submitted,

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Dated: June 25, 2001

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company **Application for review of alternative regulation plan.**	**98-0252**
Illinois Bell Telephone Company **Petition to rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates.**	**98-0335** **(cons.)**
Citizens Utility Board and The People of the State of Illinois **-vs-** **Illinois Bell Telephone Company** **Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.**	**00-0764**

NOTICE OF FILING

PLEASE TAKE NOTICE that we have this 25th day of June, 2001, filed with the Clerk of the Illinois Commerce Commission, 527 East Capitol Avenue, Springfield, Illinois 62701, AT&T Communications of Illinois, Inc.'s Reply Brief on Exceptions in the above-captioned proceeding.

PROOF OF SERVICE

I, Cheryl Urbanski Hamill, an attorney, hereby certify that copies of AT&T Communications of Illinois, Inc.'s Reply Brief on Exceptions were served on all parties on the service list on this 25th day of June, 2001, via E-Mail and U.S. Mail.

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